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Economic Conditions
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General Business Conditions

THE past month has brought a mixture of both good and bad news for the cause of the United Nations. On the heartening side have been the indications of stiffening Russian resistance and of growing offensive power demonstrated in the Solomon Islands, in the raid on Dieppe, and in the air fighting over Europe. Formal entrance of Brazil into the war has strengthened the position of the United Nations in Latin America, and especially in that strategically important shoulder of coast line jutting far into the Atlantic and most nearly approaching the Continent of Africa. With the steady increase in the strength of the naval and air forces combatting the submarine, ship sinkings along our coasts have decreased in recent weeks, and indications are that operations of the undersea raiders are being pushed farther into the South Atlantic. In the Far East, the Chinese armies, aided by the growing American air forces, have made encouraging progress.

On the other hand, in Russia the German armies have driven forward, threatening the key city of Stalingrad and the oil fields of the Caucasus and the Caspian. The situation in the Middle East is tense, with both armies apparently poised for what may prove to be the final struggle for control of Egypt and the Suez Canal. In the Far East both India, now shaken with internal political dissension, and the Russian eastern provinces are menaced with invasion, while in the islands of the western Pacific the Japanese and American sea, air, and land forces are locked in battles that may determine the balance of power.

Thus in widely different areas of the war, crucial decisions are pending, the outcome of which may mark a turning point, either hastening the end of the war or prolonging it for an indefinite period. The fact remains, however, that despite forward thrusts at some points, the tide has not yet turned in our favor and the United Nations are still on the defensive. This is not because of any failure of courage or resolution at the fighting front—there the example has been magnificent—but because of the same old trouble of too little and too late. The test is still of the home front, and of its capacity and determination to get the men and the weapons to the fighting lines.

The Production Front

On the production front, the most authoritative statement of the situation was the report of Mr. Donald Nelson, chairman of the War Production Board, rendered last month. Figures published in this report tell a story of war materials output mounting by leaps and bounds, though running behind optimistic expectations.

Production, the report said, has been unbalanced; some items have exceeded schedules, while others, including combat planes, are behind schedule. It was pointed out that the War Department, Navy Department and Maritime Commission thus far have scheduled production semi-independently, which has resulted in some scheduling ahead of overall production capacity. Moreover, forecasts of production have been increased several times. Despite difficulties in the supply of some raw materials and semi-finished products, plant shutdowns and stoppages so far are only sporadic and not general. Any inference that the war effort as a whole is slowing down is unwarranted, the report declared, although difficulties in maintaining such large monthly increases will become greater as we approach maximum output.

The production effort, it was explained, is now entering a new phase calling for more careful balancing of requirements. Production of some things must be held back; of other things speeded up. There must be effective control of the raw materials flow and of production "to make certain that the right materials get to the right places at the right time."

This report brings clearly to a focus the present production situation and what needs to be done next. The problem is to do it. The organization of the war production job has had to go forward at top speed, and in the growth of such a vast, sprawling undertaking there

was bound to be friction and maladjustment. Much of the difficulty goes back to the original overall planning, or lack of planning, on the basis of which unbalanced orders were placed, especially for use in construction of plants. With this went unbalanced construction of plants — too much of some and not enough of others, and often given to people who had great eagerness and ambition to produce but lacked the "know how" and competent organization.

This unbalance has grown as some production has far exceeded estimates and some has lagged. There has been duplication and overlapping of authority; and different departments of the Government in their eagerness to cover their requirements against all possible contingencies have competed with each other and with industry for supplies; and industries have competed with one another. As a result some products have been turned out faster than they could be used or shipped abroad, consuming vital materials and forcing a slow-down of output of other war products more urgently needed.

This poses the problem for Mr. Nelson and his associates, which he recognizes clearly, and in which he will need the support not only of the Administration and Army and Navy leaders but of industry and labor as well.

Criticism of War Management

Naturally, with the disappointments abroad and the recognition that the amount of help we have been able to give our allies has been limited, there has been criticism. Here, as in England, an impatient people has been demanding results of its leaders. And it is right that there should be criticism, provided it is sincere and not promoted by animosity or narrow, partisan motives; for in a democracy it is under the spur of criticism that faults get corrected and the needed things get done.

In appraising the war management, however, the public is in the difficult position of not liking the results, but of not knowing all the facts. It is obviously impossible to keep people generally fully informed on the thousand and one complicated and often technical problems constantly arising, many of which, for military reasons, have to be kept secret. The public is, however, entitled to feel assured that the best and most experienced minds in the country are being brought to bear on these problems, and that it can place reliance on official statements.

The employment of a Baruch, a Compton, and a Conant, as in the rubber inquiry, is the kind of thing that meets public approval and gets away from the babel of conflicting and premature statements by government officials, politicians, and so-called experts. The public will be better satisfied when it feels that equally trustworthy and able judgment is being applied at other critical points of the war effort; and that the best ability of the country is being sought out and given real power and responsibility regardless of political party, social theories, and other considerations subordinate to winning the war.

Questionable Wartime Policies

In its August survey the Office of War Information warned that "we could lose the war," and that to win we must realize that "winning it is the only vitally important thing in the world today." In the face of such warning it is difficult to see how the Government is contributing to the war effort, or setting an example of single-minded concentration on victory, by such actions as the insistence of the S.E.C. in carrying through under wartime conditions and in depressed markets the breakup of utility holding companies, and the recent announcement by the Department of Justice of the indictment of nine corporations (including some of the best-known in the country) along with six of their officers, on charges of "conspiring to defraud the Government" in connection with war contracts.

Those familiar with the leadership and record of these companies, many of which have been awarded the "E" pennant by the Government for outstanding war production performance, are confident that they have not been guilty of deliberate intent to cheat the Government. So far as the anti-trust laws are concerned, the rules and interpretations have become so complicated and arbitrary that business men frequently are not aware of having violated a law until haled into court; and the courts have often failed to support the Government's charges. In the matter of establishing prices on war products, many of which are new and ordered in unprecedented volume, they often do not know what their costs are until production is well under way. If practices indulged in have unwittingly overstepped the legal bounds, or if profits have turned out to be excessive, there are ways of adjusting these situations without pillorying the concerns before the public in a manner which in the minds of many unthinking people amounts to conviction before trial. Apart from the injustice to the companies concerned and the discouragement to enterprise, such accusations breed suspicion and distrust when national unity is necessary. Moreover, these cases call for the absorption of months of the time of the principal executives of these companies in legal proceedings when their whole energies should be devoted to the war effort.

The Inflation Front

On the inflation front, as well as on the military front, the country is still on the defensive and losing ground. With the failure of the Government to enact tax legislation that will really mop up purchasing power in the lower

brackets as effectively as in the higher brackets, and the unwillingness—at least up to this time —to place effective checks on the rise of farm prices and wages, the price control system is exposed at critical points.

Mr. Henderson has been doing a manful job in attempting to administer price ceilings in the face of the inflationary forces let loose; and he has been helped by the fact that a great many people have been using part of their increased incomes to buy war bonds and to pay their debts. In recent months the rise in the cost of living has been retarded. However, with increasing wages and farm prices, the pressure on price ceilings is inevitably increasing. As things now stand there is no ceiling on farm prices except in processed stages, and virtually none on wages. Under the formula applied by the War Labor Board, wages are to be permitted to advance in step with the cost of living, but this forms an endless spiral since each reacts upon the other. Mr. Henderson has repeatedly stressed the impossibility of holding back price inflation without effective control of these important elements of the cost of living.

Indications that there may be developing in Washington a firmer policy with respect to plugging these holes in the inflation defenses have appeared in the recent statement by Secretary of Agriculture Wickard indicating the view that under present conditions farm ceiling prices at 110 per cent of "parity" are too high, and in the statement by the President at a recent press conference that new federal action looking towards stabilization of wages and farm prices was pending. That the two problems are bound up together was recognized by the President in the remark that you cannot stabilize wages without stabilizing farm prices nor can you stabilize farm prices without stabilizing wages. And, it might be added, you cannot stabilize the cost of living without stabilizing both.

Earnings on War Contracts

During the past two years much has been said about "profiteering" by manufacturers on war contracts. Charges of "excessive," "exorbitant," and "unconscionable" profits have been bandied about so often and so indiscriminately that many people have been led to believe, by mere force of repetition, that industry generally —and the large corporations in particular— were piling up big profits on war business.

Some of this talk, of course, reflects merely the usual agitation against the corporations, founded on ignorance and prejudice. Some of it is political or has arisen out of attempts to justify wage increases. Some of it is by sincere well-meaning people who are not well acquainted with the facts and have been misled by propaganda, or by isolated but highly publicized cases of excessive profits. In many cases the profits cited have been before allowance for taxes and other necessary charges. In other cases, sharp increases in net income, caused by a transition from part time to fulltime and overtime operations, have created a false impression as to true earnings. And, finally, much of the gain recorded in business earnings up to this year was not on war contracts, but from the production of ordinary peacetime goods, the demand for which was stimulated by anticipation of coming shortages.

With the publication of earnings reports for the first quarter and the half year just passed, evidence is now coming to hand as to the truth about "war profits." For 125 of the largest arms contractors for which net income and tax figures are available, the net income after taxes for the first half year 1942 was 36 per cent below that of last year, as will be seen from the following comparisons:

Earnings for the Half Year of 125 Manufacturing Companies Holding Large War Contracts
(In Thousands of Dollars)

	First Half Year 1941	First Half Year 1942	Percent Change
Net income before taxes....	$1,320,204	$1,564,223	+18
Fed. income & e.p. taxes	691,545	1,160,811	+68
Net income after taxes......	$ 628,659	$ 403,412	—36
% of net inc. taken by taxes	52	74	

This summary is based on the available reports showing net income and tax figures for the first half-years 1941-1942 of the manufacturing companies holding the largest war contracts as indicated by the O.P.A. weekly press releases on government contract awards from the start of the expanded defense program in June 1940 until such releases were discontinued last year, and also of companies which have been awarded the Navy "E" or the joint Army-Navy "E" for excellence in production. Industries represented include iron and steel, non-ferrous metals, machinery, electrical equipment, automobiles and parts, railway equipment, aircraft and engines, shipbuilding, chemicals and explosives, petroleum refining, building materials, textiles, shoes and rubber products. The remaining companies having large contracts or the "E" award issue only annual reports, or have been requested by the Army Air Corps to issue no quarterly statements, or are closely held and publish no financial details.

These figures are particularly significant because this year for the first time the earnings reflect to a material extent the concentration on war production, combined with the steeply increased taxes. During this period the transition of industry from peacetime to wartime production made rapid progress, resulting in many lines in the virtual elimination of civilian output, heretofore a major contributing factor in increased earnings. Not only are current earnings of this group substantially below 1941, but 22 per cent below even the first half of 1940, before the expanded national defense program got under way.

Reserves for federal income and excess profits taxes, computed in most cases at the proposed rates of the 1942 revenue bill as passed by the House, increased from $692 millions in the first

half year 1941 to $1,161 millions in 1942, while net income after taxes dropped from $629 millions to $403 millions, or by 36 per cent. Taxes this year absorbed 74 per cent of the net income, thus exceeding by 3 to 1 the net income available to the corporations and their shareholders for payment of dividends, and for investment in fixed and current assets necessary to expand production still further.

Annual rate of return on the capital and surplus of this group, which had been built up from approximately $10,280 millions at the beginning of 1941 to $10,711 millions at the beginning of 1942, declined from 12.2 per cent in the first half year 1941 to 7.5 per cent this year.

Sales figures also were given by 55 of the companies, and increased from $5,053 millions in the first half year 1941 to $5,561 millions this year, or by 10 per cent. Despite this gain in volume, however, the margin of net profit to sales declined from 7.1 to 3.8 per cent. Much higher rates of earnings before taxes are sometimes cited as proof of excessive profits on war contracts, but such comparisons obviously are misleading so far as real income is concerned, when no allowance is made for the fact that taxes absorb 74 per cent.

It is possible that for some companies now fully converted to war production, the second half-year may show an improvement in earnings over the first half, which was burdened with expenses of change-over. On the other hand, for many companies the curtailment of peacetime goods production and the shift to war products giving narrower margins is still in process, while operating costs for labor, materials and taxes are continuing upward. Moreover, numerous reports have pointed out that the income shown on interim statements is subject to downward revision, because of possibly increased taxes, year-end reserves and adjustments, and "renegotiation" of contracts as now provided by law, when the books are audited after the close of the year.

Whatever may be the situation as to exceptional cases, the returns now becoming publicly available fail to support the charge that industry generally is making excessive profits on war orders.

Progress of the Tax Bill

During the past month the Senate Finance Committee has made good progress in considering the tax bill. Public hearings were concluded August 15, and the Committee is now engaged in preparing its amended version for submission to the Senate. Already a number of important tentative decisions have been announced.

Confirming the action of the House Ways and Means Committee, the Senate Committee has tentatively disapproved three of the so-called "loophole" taxes urged by the Treasury,—namely, the proposals for mandatory joint returns, for elimination of the 27½ per cent depletion allowance on natural resource industries, and for taxation of interest from outstanding state and municipal securities.

All three of the proposed taxes have been subjected to severe criticism. Mandatory joint returns infringe upon the rights of women as individuals and penalize marriage. Reduction of depletion allowances in the case of natural resource industries such as oil and mining carries risks of discouraging exploration and development at a time when increased production is greatly needed. Taxation of outstanding state and municipal securities involves questions of constitutionality and good faith, and was strongly opposed also on grounds of adding greatly to the financial problems of local governments. The Senate Committee, however, voted tentatively for taxation of future issues of state and municipal securities, which does not involve the same ethical questions.

In all of these rejected taxes the complications involved are large in proportion to the revenues at stake. In none of them is inflation prevention an important issue; for the taxes proposed would fall mainly upon the corporations and upper individual income brackets, whereas the inflation danger lies mainly in the expanding industrial payrolls which constitute the vast addition to buying power.

Objectives of Wartime Taxation

Among the various reasons for increasing taxes in wartime, the following will be generally agreed upon as paramount:

1. To pay as much as possible of the war cost currently, and thus hold down the debt increase, and

2. To recapture excess income disbursed by the Treasury and thus check inflationary spending.

The tax bill as it came from the House does not go far toward accomplishing either.

Although calling for $6,271 millions of additional revenue, the largest tax bill in the country's history, the bill nevertheless falls some $2½ billions short of the $8.7 billions asked for by the Treasury, and stated by Secretary Morgenthau to be "the very least that the American people could afford to provide." On this basis the Treasury will be covering only about one-third of the estimated expenditures this year by revenue, and the debt increase will be something like $54 billions, of which between $25 and $30 billions may have to be financed by the banks. This is a highly inflationary outlook.

Not only is the present tax bill inadequate in size, but it reaches the wrong places if the objective is to prevent inflationary spending.

In the bill as it passed the House, additional taxes were called for in categories and amounts as follows:

(In Millions of Dollars)

Individual income tax	$2,872
Corporate income tax including excess profits..	2,641
Miscellaneous taxes	758
Total	$6,271

As will be seen, the largest amount of tax increase falls on the individual incomes. This comes about by lowering tax exemptions on single persons from $750 to $500 and of married persons from $1500 to $1200, except for members of the armed forces; raising the normal tax rates from 4 to 6 per cent; and raising the schedule of surtaxes to begin at 13 per cent on the first $2000 of taxable income, as against the present 6 per cent, and take 82 per cent of everything over $200,000.

The lowering of personal exemptions and doubling of the rate at which the surtax begins represent recognition by Congress and the Treasury of the need for broadening the tax base, both for the sake of tapping new sources of revenue and of siphoning off new purchasing power where it is being created. The changes will add large numbers of new taxpayers to the lists, and are steps in the right direction. The lowering of credit for dependents from $400 to $300, as tentatively voted by the Senate Committee, will bring in still more taxpayers.

But because of the steeply graduated surtaxes, the bulk of the increased tax will still come, not from new taxpayers, but from the middle and upper incomes which have been carrying the main burden right along. Despite the lowered exemptions, an income of $2000 for an average family of four would still pay no income tax. According to a statement by Senator Taft who is a member of the Finance Committee, the bill as it stands will fail to reach two-thirds of the people's income. Continuing, Senator Taft said:

. Out of a total of $95 billions of net income received by 130 million individuals, $36 billions, or 37 per cent, escapes taxation altogether. It isn't even shown on any income tax return.

Thirty-two and one-half billion dollars more is exempt under the personal exemptions, earned income credit, and credit for dependents. Only 26½ billion of income out of $95 billions, or 28 per cent, pays income taxes. The total paid by 130 million people is $2½ billion less than what we are collecting from business corporations.

About half of what we do get from individual incomes comes from those with incomes of more than $10,000 a year. We get more money from liquor and tobacco taxes than we do from the income of 90 per cent of the people whose net income is $3,000 a year or less.

Second in importance from the standpoint of new revenue come corporate income and excess profits taxes, expected to yield 42 per cent of the total increase. As a deterrent to inflationary spending, however, such taxes have little effectiveness. What with existing taxes, priorities, and rationing, few corporations outside of necessary defense industries are in a position to increase expenditures anyhow.

This leaves $758 millions, or 12 per cent, to be raised in miscellaneous additional excise taxes; and even a part of this would consist of excise taxes that fall on business rather than upon consumption.

In other words, the bill in its present form will make little impression upon the vast amount of purchasing power being generated by Treasury expenditures which is threatening to drive up prices and cause inflation. Instead of seeking the additional revenue at the points where most of the new income is being created, the measure in general follows the familiar line of concentrating new taxes mainly on the corporations and relatively well-to-do individuals which have borne the brunt of taxes thus far and which offer politically the easiest source of tax collection.

Senate Committee Testimony

Testimony before the Senate Finance Committee has given clear evidence that the country cannot hope to build a sound financial program on so narrow a base. In one instance after another it was shown that the proposed 45 per cent corporate normal and surtax and 90 per cent excess profits tax would endanger seriously the efficiency of companies engaged in war production, impede the accumulation of postwar reserves, and threaten many concerns, particularly new and growing businesses, with extinction. In the case of both corporations and individuals the proposed rates are so high that Congress is being forced to give consideration to various measures of limited tax relief, such as allowance for debt payments, and for certain forms of savings, including life insurance commitments. The latest proposals of the Senate Committee to place an 80 per cent ceiling on the total tax of any corporation and allow a postwar credit of 10 per cent are effective moves in this direction.

Despite these rates, the amount of revenue expected from the bill is generally conceded to be totally inadequate. Senator George, Chairman of the Senate Finance Committee, has repeatedly expressed the opinion that the total revenue income should be much greater if inflation is to be prevented.

What conclusion then is possible other than the need for some additional tax of wider coverage which will spread the load among all the people and reach more effectively those important areas of increased income heretofore practically untouched? It is this situation which has made the arguments for the sales tax increasingly impressive. Not only is this a tax of widespread applicability, but it is a tax on consumption; and it is consumption in war-

time that needs to be reduced. As the tax system now stands, it bears chiefly on savings and on the instruments of production, which as a wartime system of taxation simply does not make sense.

The Ruml Pay-As-You-Go Tax Plan

The increased coverage and high rates of personal income taxes, with the inevitable increase in difficulties of tax collection, have enlisted growing support for the pay-as-you-go plan proposed by Mr. Beardsley Ruml, treasurer of R. H. Macy & Co., and chairman of the Federal Reserve Bank of New York.

In brief, what the Ruml plan offers is a way of adjusting income tax payments to a current basis, instead of the present one-year lag, without forcing a "doubling up" of taxes on the taxpayer in the year of changeover.

That an adjustment of some kind to a pay-as-you-go basis is needed has become increasingly evident as the war tax program has advanced.

For one thing, the expansion in the number of taxpayers from a comparatively small number to some 20 millions, many of whom are not accustomed to make out forms, has greatly increased the need for some form of withholding tax, or collection at the source, to ensure collection and lessen the trouble and expense to the Treasury of checking millions of small returns. And a withholding tax is, of course, a pay-as-you-go tax.

Secondly, the high rates to which taxes have advanced have made it more than ever desirable for individuals to pay taxes currently as income is received and when they have the money, rather than wait a year until the money may have been spent and the ability to pay taxes possibly reduced by shrinkage of income. Because of the tendency towards delay in passage of tax bills until late in the year, but with taxes retroactive to the first of the year, people do not even know what their tax liabilities are until too late in many cases to make adequate provision for them.

Thirdly, the lag of one year in tax collections enhances the danger of inflation. With incomes rapidly increasing, the situation calls for taxes that can be applied promptly and mop up purchasing power before it can be spent.

The Treasury has recognized the need for pay-as-you-go taxation, and in a statement on the Ruml plan said that the present method of collecting taxes in the year after the income is earned is "poorly suited to a mass tax at high rates." The current tax bill provides for a beginning in this direction by requiring, starting January 1, 1943, a 5 per cent deduction of tax at the source, to be followed by 10 per cent in 1944. The difficulty is that any change of this kind runs headlong into the problem of collecting two years' taxes in one, which with rates as high as at present would mean a total levy that large numbers of people would have very serious difficulty in meeting.

To avoid this doubling up, the Ruml plan proposes that individual income taxes now being paid on 1941 incomes be considered as taxes on 1942 incomes instead. In 1943 the taxes payable would then be taxes on 1943 income, and the whole system would be on a current or pay-as-you-go basis. Adjustments for the difference between taxes paid and actual tax liability in any year would be made the year following. While this plan means the dropping out of the taxes on 1941 income, the Treasury would continue to receive its revenue and the taxpayer would continue to pay his taxes. It would not involve any writing off of assets by the Treasury, whose accounts are handled on a cash rather than accrual basis, but would mean, of course, a loss of one year's taxes when and as each individual taxpayer's income ceased. Such loss would thus be spread over the lifetime of those already paying taxes, and would be offset in part if not entirely by lessened tax evasion and tax delinquency, higher estate taxes, and the fact that future tax rates should be far lower than present wartime rates.

The Treasury, while endorsing the pay-as-you-go objective of the Ruml plan, opposed the dropping out of the tax on 1941 incomes in their entirety on the grounds that it would constitute a "windfall" to some taxpayers having large incomes in that year, and suggested that only the normal tax and the surtax on the first bracket of $2000 of net income should be dropped. The Senate Finance Sub-committee, headed by Senator Clark of Missouri, voted to recommend to the full committee the Ruml plan, with some modifications, but rejected the above alternative suggestion offered by the Treasury.

The full Senate committee at first rejected the report of this sub-committee, but as this goes to press, is reconsidering the matter in response to a widespread public interest in the plan.

Money and Banking

The long expected cut in reserve requirements of the New York and Chicago banks came last month and restored over $400 millions to the surplus reserves of the banking system. The Reserve Board's action consisted in lowering from 26 to 24 per cent the required reserves against demand deposits in the two central reserve cities without changing the requirements of other member banks, and makes the requirements for the different classes of banks and of deposits as follows:

Member Bank Reserve Requirements
(Percentage of Deposits)

On net demand deposits:	
Central reserve city banks	24
Reserve city banks	20
Country banks	14
On time deposits:	
All member banks	6

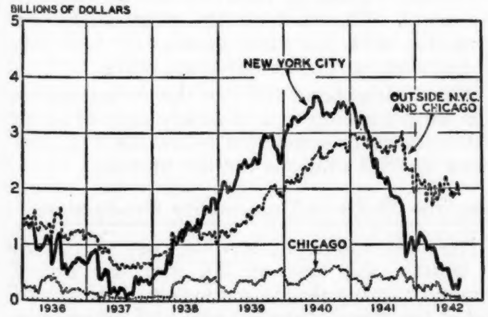
The foregoing action had been foreshadowed by the authorizing legislation sponsored by the Reserve Board and passed by Congress in July, and by the low levels to which excess reserves in New York and Chicago had declined. With the falling off in gold imports last year and the continued and accelerated expansion of currency and bank deposits, excess reserves of all banks have been undergoing a steady shrinkage, reducing them over the past year and a half from $7 billions to around $2 billions.

Concurrently with this decline has been a constant filtering of funds from the central money markets to other parts of the country where the war industries are located. This has meant throwing the brunt of the excess reserve drop on these two centers and made it an increasing problem to keep them supplied with enough funds to play their necessary part in the flotation of new Treasury issues constantly coming along.

Heretofore this outflow of funds had been offset in part through open market operations by the Federal Reserve Banks, but as the drain on the money centers continued it became evident that sooner or later some further action would have to be taken. By confining the reserve change to New York and Chicago the effect was to ease the reserve position where it was getting tight without at the same time adding to the volume of excess funds in areas already adequately supplied.

Lowering of reserve requirements released $345 millions of excess reserves in New York and $70 millions in Chicago, carrying the totals in the two cities to $525 millions and $86 millions, respectively. Not all of these increases, however, were retained, and figures for the final reporting date of the month (August 26) showed "excess" totals of $375 millions for New York, $83 millions for Chicago, and $2,300 millions for the System as a whole.

The diagram below shows the trend of excess reserves in the two principal money markets and for "all other" member banks.



Excess Reserves of the New York, Chicago and All Other Member Banks

Besides the change in reserve requirements, the Reserve Board announced early in the month an extension of the bill purchase policy, whereby Reserve Banks will not only stand ready to buy Treasury bills offered at the fixed price of 3/8 per cent, as heretofore, but will resell such bills to the former holders at their option without penalty as to price. In this way any bank has the assurance of being able to convert its bills into cash in a pinch without prejudice to its earnings position as soon as it is in funds again.

Both the action on reserves and the extension of the bill policy are further evidences of the purpose of the authorities to give every possible aid to the banks in their task of carrying their share of the war financing load.

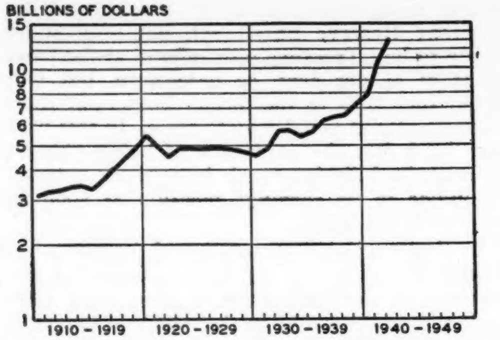
The Continued Rise in Currency

The continued rise in currency, which has been an important factor in pulling down bank reserves and calling for continual replenishment of funds, is of course no new development but has been going on for a number of years and has been the subject of much comment. Instead of coming to an end, as often predicted, the rise has continued and even grown more rapid in the past two years.

Various factors have contributed to this withdrawal of funds from the banks and their conversion into cash. In the early '30s there was the fear induced by bank closings; and a greater need for currency was caused by the reduction in the number of banks operating. Later, as the fear factor diminished, other factors became influential, including particularly the reduction or elimination of interest payments on bank deposits, and the extension of service charges on checking accounts. Also there was a considerable export of United States notes for use abroad. New factors during the past two years have been the sharp rise in industrial and agricultural incomes, wage payments to large numbers of war workers having no bank accounts, and payments to our armed forces.

In addition, there apparently has been considerable hoarding here of both domestic and refugee capital by people who preferred to keep their money in the form of currency rather than bank deposits because of fear that bank deposits might be "frozen" or seized, or in some instances that bank records might at some later date be used against them as evidence of income tax evasion or illegal business transactions.

In the next diagram showing the trend of circulation since 1910, it will be seen that there was also a sharp increase during the last war. Money in circulation at the end of June 1914 amounted to $3,459 millions, from which it increased by about 21 per cent to the time of our entrance into the war in April 1917, and increased a total of 50 per cent to the time of the armistice in November 1918. There was a



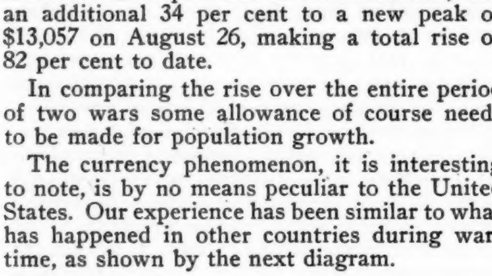
Long-term Trend of Currency Circulation in the U. S.

further sharp rise during the post-armistice boom to the peak in 1920.

So far during the present war the increase has been at a sharper rate, although precise comparisons are difficult because of important differences in general conditions and banking practices, and the problem of deciding exactly what periods to compare. Money in circulation at the start of the present war on September 1, 1939, amounted to $7,171 millions, from which it increased 48 per cent to Pearl Harbor, and an additional 34 per cent to a new peak of $13,057 on August 26, making a total rise of 82 per cent to date.

In comparing the rise over the entire period of two wars some allowance of course needs to be made for population growth.

The currency phenomenon, it is interesting to note, is by no means peculiar to the United States. Our experience has been similar to what has happened in other countries during wartime, as shown by the next diagram.



Currency Circulation in Three Countries

Since 1939 the upward trends of currency circulation in the United States and England have been running roughly parallel, while in Canada the rate of increase has been somewhat higher. In Canada the causes attributed have been identical in part to those recognized here and in England—increased payrolls, farm income, living costs and pay to the armed forces. Canadian rearmament, however, started earlier than ours, and the movement of population, including retired people and women, into the new and expanding war industries no doubt has been greater relatively than in this country. There is said to be no evidence that hoarding has been an important factor in the increase of Canadian circulation.

Progress of Treasury Financing

Last month's major offerings by the Treasury of a "tap" issue of long-term bonds and an issue of short-term certificates were both highly successful. Subscription books for the bonds, carrying a 2½ per cent coupon and maturing in 20-25 years, were open from August 2-15 and brought applications totaling $1,236 millions. This exceeded by a large margin the first "tap" issue, which had similar terms and was offered May 3-13, bringing subscriptions of $882 millions. These bonds, which commercial banks are not permitted to own until after ten years, are designed especially for insurance companies, savings banks, trust funds, and other long-term investors.

Allotments on the issue of ⅞ per cent certificates dated August 15 and maturing in 11½ months amounted to $1,609 millions. Of this total, 57 per cent was taken outside the New York district, against 53 per cent of the ⅝ per cent certificates sold in June, and 44 per cent of the ½ per cent certificates sold in April when that type of security was reintroduced by the Treasury.

This indicates a progressively wider distribution which has the desired effect of throwing more of the financing on the "outside" banks where excess reserves are larger than in New York. Of the net increase of $845 millions in certificate holdings by reporting banks during the allotment week, 63 per cent took place in the banks outside New York City. The increase in rate on the certificates to ⅞ per cent has given them a wider appeal not only to interior banks but also to corporations and other non-banking buyers for temporary investment, including reserves for income tax payments. The rate on the new certificates compares with the yield of slightly less than ½ per cent on tax anticipation notes.

War savings bond sales for the period August 1-26 were running at a monthly rate of about $700 millions or somewhat below the Treasury quota of $815 millions for the month.

Wartime Shifts in Commodity Production

The first and most terrible cost of war is, of course, the loss of life and the untold human suffering that war involves. The second cost is the direct financial cost and destruction of wealth. Still a third cost is the economic dislocations that follow in its train. War closes some markets and opens others. It sets up impassable barriers to the exchange

of goods, where none previously existed. It creates within one closed area a surplus of some commodities and a shortage of others; while in another area the converse exists. It interferes with transportation. Within areas cut off from accustomed sources of supply it stimulates new production and development of synthetics and substitutes. Everywhere it encourages output of war commodities as against those for civilian use.

The upheavals in commodity production and trade caused by the first World War had effects which long survived that war, and the adjustments that will have to be made because of this war loom even greater. Regions untouched by the first war have been engulfed in this conflict, and mobilization of resources to meet war needs has been pushed to a degree never thought possible. The first World War divided the world into two trade areas,—Central Europe and all the rest. Central Europe forthwith was started on a search for synthetic products and substitutes, while the Allies, having access to most of the essential resources, turned to the development of mining and agriculture and to improvement of metallurgical and mechanical processes. Postwar commodity maladjustments were especially glaring in bread grains, sugar and industrial raw materials outside the Continent of Europe.

The problems growing out of this war are more complicated. Creation of additional capacity for producing war commodities is greater, because mechanized war makes greater demands on resources. The present struggle cuts across many more frontiers, and submarine activity has made the disruption of trade more profound. Search for substitutes and synthetics, and application of new uses for older products, have been encouraged on a scale much larger than during the first World War. Neither the United Nations nor the Axis Powers and Japanese have in the countries they control, or still trade with, the full complement of resources essential for war; but they have scientific resources incomparably greater than twenty-five years ago.

With few exceptions, the World War I synthetics did not survive the war, either because they were inferior, or because they could not compete in cost with the natural product. What is significant this time is that the synthetics and substitutes in many cases are not inferior. Through chemical research and technical efficiency these synthetics have been given properties which make them often better fitted to certain special needs than the natural products.

Thus World War II has accelerated the trend—on the way before the war in fibers and plastics—from natural to "made-to-order" products. Synthetics complicate the return to a peacetime economy, but are here to stay.

The Future of Rubber

The most spectacular and important shift in commodity production resulting from the war is taking place in rubber; and the rubber problem may be the most difficult to solve, not only because of the huge excess capacity created, but also because of political and strategic considerations involved. There will be a huge synthetic rubber industry, itself able to take care of most of the current demands; in the United States alone the contemplated annual capacity is around 900,000 tons. Prewar synthetic rubber plants in the Axis countries and the Soviet Russia undoubtedly have been expanded toward providing for war needs; and new plants are reported in other parts of the Continent, including Spain. Eventually also there will be at least 100,000 tons additional natural rubber each year available from Latin America, Africa and India. All told, the postwar natural and synthetic rubber capacity is likely to be at least double that of the peak pre-war consumption, which for the world was about 1,100,000 tons of crude and between 100,000 and 200,000 tons of synthetic.

No one can now foretell the disposal of this surplus capacity. Much will depend, of course, upon the outcome of the war and upon the territorial changes involved. For political and military reasons, the retention of some synthetic capacity may be advisable in order to guard against recurrence of our present embarrassment. Much will depend on constant improvement of the synthetic product,—on its ability not only to replace natural rubber but to win for itself new uses. Price too will remain an important factor. If, as a result of technical progress, the prices of both the synthetic and natural product are low and stable, new markets may expand amazingly,—for example, in railroad equipment, paint and clothing industries, and food packing; and the motorization of Asiatic countries and of Latin America will be facilitated, thus helping to vastly enlarge the market.

Demand for Nonferrous Metals

The basic nonferrous metals—copper, lead, zinc and tin—face problems of expanded capacity, as after World War I, but also other complications. New competition has arisen in the tremendous expansion in production of the light metals—aluminum and magnesium—and from substitution of glass and plastics.

Inroads of aluminum upon the use of copper during the First World War were relatively small, being retarded by the price of above 60 cents per pound, from which it has been lowered to 15 cents today. During the present war the use of aluminum and magnesium is growing faster than any other metal. Their combined world production will exceed 2,500,000 tons by 1943 as compared with about 600,000

tons in 1938. Despite this phenomenal gain, the chances for finding uses after the war are promising indeed. While the bulk of aluminum may continue to go into aircraft production, many new uses are likely to appear in the automobile, railway equipment, electric apparatus and other industries.

New capital goods industries of Canada, Australia, South Africa, Argentina, Brazil and China may be counted on to absorb a part of the increased production of the nonferrous metals. The backlog of accumulated demand for automobiles and other equipment and the reconstruction of devastated countries should also provide a big post-war market. On the other hand, once the war is over, there will be a large volume of secondary metal thrown on the market from war scrap and reserves. The relation of secondary copper to total supplies in this country rose from about 15 per cent in 1913 to 33 per cent by 1939, and may rise even higher after the present war.

Post-war outlook for tin does not appear encouraging. The loss of two-thirds of the world tin supply to the Japanese has hastened the development of tin mines in Bolivia, Nigeria, Belgian Congo, Australia, South Africa and Argentina. By the end of the year the production controlled by the United Nations is expected to reach an annual rate of almost 90,000 tons, or about two-thirds of current requirements. At the same time that considerable producing capacity is added, steps are being taken to replace tin by other metals for solders and bearings, and by glass, plastics and paper for containers. The new electro-tinning process now being installed in this country is expected to reduce the use of tin per container by at least one-third. A new balance, on a lower level between tin consumption and production may result from the war.

The Changes in Textiles

As a whole, cotton and wool production in the older exporting countries declined during the first World War. Cotton cultivation spread to a number of new countries and some replacement of cotton by synthetic fibers began. Most significant was the spread of the textile manufacturing industry outside of Europe and the resulting shift in the world cotton trade. Wartime withdrawal of European countries from export markets gave an opportunity to cotton textile industries in India, China, Canada and Brazil to establish themselves in local markets. In addition the Japanese cotton industry captured a substantial portion of the export trade. In the ten year period 1913-1923 the Asiatic consumption of cotton doubled, while that of Europe declined by one-third.

Developments during the present war have followed this pattern more closely than most people may realize. Wool and cotton production of major exporting countries has remained at a fairly steady level, with stocks accumulating because of scarcity of shipping. New countries are experimenting with cotton cultivation and some, especially in Latin America, are covering an increasing share of cotton textile needs. Instead of Japan, it is now India and Brazil which are entrenching themselves in the cotton export trade.

On the Continent of Europe, meanwhile, a considerable part of former cotton and wool requirements is now supplied by synthetic fibers. Most of the cellulose surpluses of Northern Europe, for which the paper industries in this country and Great Britain were the market, are now sent to the synthetic fiber plants on the Continent. New sources of cellulose are being tapped: straw, reed, potato tops, flax sheaves and other agricultural waste material.

Since the coming of nylon, the American consumption of silk has been greatly curtailed. World War II is speeding up the exit of silk, whereas World War I saw a huge expansion in demand for silk apparel as a consequence of wartime prosperity in this country. The Japanese are reported to have already curtailed the silk crop to about 450,000 bales from about 725,000 bales before the war.

Surplus of Carbohydrates vs. Scarcity of Proteins

Maladjustments created by the first World War in production and distribution of agricultural products involved mainly the carbohydrates, bread grains and sugar. This time it is the protein foods, meat, fats and dairy products which are being affected.

Prior to World War I, the Western European Allies and the neutrals normally imported between 400 and 500 million bushels of wheat annually. Closing of the Black Sea cut them off from the Russian and Roumanian surpluses, while their own crops declined because the war was fought on some of the best wheat and sugar lands on the Continent. The shortage was made up by increasing the area under wheat in the United States, Canada, Argentina and Australia. During the war, and immediately after, when Europe would buy food at any price, these countries increased their wheat acreages to an extent which later glutted the market when Europe got back into production. This was the basic cause of the agricultural depression, tracing directly to the disruption of established production by the war, and ushering in the great depression long before it affected the manufacturing industries.

The sugar problem was similar. European sugar beet output was reduced from about 8.2 million tons in 1913 to 2.6 million tons in 1919.

Proximity to consuming centers encouraged sugar production in the Caribbean area in particular, but sugars from Pacific and Indian Ocean countries continued to be available to the Allies. Post-war developments, technical progress and expanded production aggravated the subsequent crisis and led to curtailment of free markets for sugar, but the stimulus to production originated in the wartime prices.

As to proteins, meats and fats, the first World War decline in output in Western Europe and Scandinavia was made up principally by expansion of hog raising and dairy farming in the United States. However, we had to give up the war-won markets when production on the Continent recovered and when Canada, Australia and New Zealand took to the diversification of their agriculture to counteract the post-war crisis. The subsequent readjustment of our hog and dairy production to domestic needs was accompanied by depression prices.

During the present conflict the isolation of the Continent of Europe has caused the loss of a market for some 200 million bushels of overseas wheat. In the exporting countries wheat is piling up, and the carryover this July was almost as big as the new crops. In contrast with World War I, however, wheat acreage is being reduced rather than expanded, which may eventually improve the supply-demand relation.

Among the cereal grains, rice presents a new problem which did not exist during World War I. With the occupation of the great rice surplus regions of Burma, Indo-China and Thailand, something like 95 per cent of the rice entering world trade came under Japanese control. India, formerly the principal market for this surplus rice, is enlarging its production to become self-sufficient, and the Western Hemisphere, which normally covered a part of its requirements by Oriental rice, this year has become a surplus producer.

No important shifts in sugar production appear to be taking place. Despite the loss of surplus sugar areas in Java and the Philippines, the United Nations should have a sufficiently large production of sugar left in the Western Hemisphere and Indian Ocean region to provide for their restricted needs, provided shipping is available. It may be necessary, however, to increase the West Indian sugar output if Soviet Russia is to be supplied in the future. It is reported that the Japanese are diverting some of the land under cane in the occupied countries to other industrial crops, cotton in particular.

Carbohydrate Conversion into Proteins

The most serious dislocations loom at present in the world production of edible and inedible fats. The Western Hemisphere has been called upon to make good the loss of copra, coconut oil and palm oil from the Philippines, Malaya and the Netherlands East Indies, and at the same time to provide additional fats to cover industrial requirements for explosives and possibly also Russian needs later on.

To fulfill these requirements, the planting of vegetable oil bearing crops has been expanded all over the Western Hemisphere. Development of Brazil's great potential supplies of babassu and other nuts is, however, dependent upon labor and shipping availability. At the same time, large surpluses of corn and wheat can be fed to livestock to produce animal fats. Thus the basis has been laid for another wartime expansion of hog production in the United States, for a new hog industry in Canada and Argentina. Argentina, and Brazil and possibly other Latin American countries will emerge with important dairy industries.

In the meantime shifts in protein production are taking place also on the Continent of Europe. The Germans are striving to make up for the loss of overseas supplies and the decline in livestock production in the Netherlands and Denmark by intensifying hog raising in the Danubian basin as well as by cultivating oilseed crops on a much larger scale.

The Postwar Problem

Upheavals in the production and distribution of major industrial raw materials and foodstuffs described above represent, of course, a transitory stage. The longer the war, the wider will be the economic gaps among the three groups of countries into which the world is divided; the more difficult will be the adjustment of newly-created interests with the old ones; and the more changed will be the character of international trade. Solution of maladjustments created by the war and the transition into peacetime economy will be more difficult than after the first World War.

But the problem is far from hopeless. Increased productive capacity, new techniques of production, and new synthetics, may all be made to facilitate rather than hinder the postwar adjustments. All the economic progress that mankind has made has been derived from increased capacity to produce goods and services. There is never general overproduction, but only unbalanced production, restricted distribution, and underconsumption. Vast increases in productive capacity should be cause for rejoicing and should contribute to a higher standard of living all around. The problem is one of organization of production and distribution that all may benefit. This will be the challenge of the postwar economic world.

MOBILE FORCES

ON the land, by sea, and in the air, the armed forces of the United States are showing their power to strike quickly and vigorously. They are mastering the new requirements of new warfare.

American industry is making the change-over from peace to war production with amazing speed. American railroads are meeting the extraordinary new demands upon them. Farmers are achieving new goals in type and volume of output.

America's banks also are not fighting trench warfare, but have thrown their strength forward in aggressive action. They are making new kinds of loans. They lead the way in the sale of war bonds. They have pledged their own resources. Along with the armed forces and industry and agriculture they are showing that democracy can be mobile.

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